January 23, 2006

*Via Electronic Filing*

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

*RE: Petition by the Securities Industry Association for Additional Delay in the Compliance Date of Rule 202(a)(11)-1 (File No. S7-25-99)*

Dear Ms. Morris:

On behalf of the Investment Adviser Association,[1] we are writing to respond to the petition filed by the Securities Industry Association to further delay implementation of Rule 202(a)(11).[2] We offer two points for the Commission's consideration.

First, we wish to clarify that the SIA is *not* requesting an additional delay with respect to the effective date of the rule as it pertains to whether an account will be treated as a brokerage account or an advisory account based on whether the broker exercises investment discretion. Given SIA's statement that brokerage firms will be able to comply with the discretionary brokerage aspects of the new rule by the January 31, 2006 compliance date, we assume that any action by the Commission on the SIA's most recent petition will not result in further delays in implementing these aspects of the rule.

Second, we take this opportunity to reiterate our views that the Commission needs to enforce the final rule and to educate investors about the practical implications of the rule. Last summer, we wrote to Chairman Donaldson about the study proposed in the

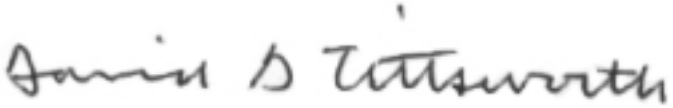
[1] The Investment Adviser Association (formerly the Investment Counsel Association of America) is a not-for-profit association that represents the interests of SEC-registered investment adviser firms. Founded in 1937, the Association's current membership consists of more than 425 firms that collectively manage in excess of $5.5 trillion for a wide variety of individual and institutional clients. For more information, please visit our web site: www.investmentadviser.org.

[2] *See* Letter from Ira D. Hammerman, General Counsel, SIA, to Nancy M. Morris (Jan. 10, 2006). *See also*, Letter from Carl B. Wilkerson, General Counsel, American Council of Life Insurers to Nancy M. Morris (Jan. 13, 2006). The letters did not become publicly available until they were posted on the Commission's web site on January 18, 2006.

release accompanying the final rule.[3] In addition to outlining our views on the proposed study, we urged the Commission "to dedicate adequate resources to ensure that the rule is properly implemented and that broker-dealers comply fully with its requirements." We also urged the Commission to "play a much more proactive role in educating investors and consumers about the fundamental issues involved in this rulemaking." We continue to believe that the Commission, consistent with its mission of investor protection, needs to take steps to ensure that the rule is being enforced and to educate consumers about the rule. To our knowledge, the Commission has not developed any document or resource for investors about the confusion that exists about the difference between brokers and investment advisers, when an account will be treated as a brokerage or an advisory account, or what disclosures they should expect to receive under the final rule. The Commission's own research has underscored the fact that investors are very confused about these issues and we believe the Commission can and should take action to help to address this confusion.

Please do not hesitate to contact us if you have any questions or need any additional information regarding this matter.

Sincerely,



DAVID G. TITTSWORTH
Executive Director

Cc: Hon. Christopher Cox
Hon. Cynthia A. Glassman
Hon. Paul S. Atkins
Hon. Roel C. Campos
Ms. Annette L. Nazareth
Ms. Susan F. Wyderko
Mr. Robert L.D. Colby
Mr. Robert E. Plaze

[3] *See* Letter from David G. Tittsworth, Executive Director, Investment Adviser Association to William J. Donaldson (June 22, 2005). The June 22, 2005 letter is attached and we ask that it be incorporated in the record relating to the SIA's current petition.

June 22, 2005

*Via Electronic Filing*

The Honorable William H. Donaldson
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

**Re: Certain Broker-Dealers Deemed Not To Be Investment Advisers, Release Nos. IA 2376; 34-51523; File No. S7-25-99**

Dear Mr. Chairman:

The Investment Adviser Association[1] is taking this opportunity to discuss certain aspects of the final rule[2] recently issued by the Commission relating to the exception for broker-dealers under the Investment Advisers Act of 1940. In addition, we are writing to provide our initial reactions to your request for Commission staff to prepare a report on options and recommendations for a study that would, among other things, compare the "levels of protection afforded retail customers of financial service providers under the Securities Exchange Act and the Investment Advisers Act, and to recommend ways to address any investor protection concerns arising from material differences between the two regulatory regimes."[3]

Our organization has been actively involved in the debate involving this rule for many years. Since the original rule was proposed in 1999,[4] we have filed numerous comment letters with the Commission on the subject, both on behalf of our organization as well as joint letters with other interested parties.[5] We believe the rulemaking is of

[1] The Investment Adviser Association (formerly the Investment Counsel Association of America) is a not-for-profit association that exclusively represents the interests of SEC-registered investment advisory firms. Founded in 1937, our membership today consists of nearly 400 firms that collectively manage about $5 trillion in assets for a wide variety of individual and institutional clients. For more information, please visit our web site: www.investmentadviser.org.

[2] *Certain Broker-Dealers Deemed Not To Be Investment Advisers*, Release Nos. IA 2376; 34-51523; File No. S7-25-99 (Apr. 12, 2005) ("Release").

[3] *Id.*, at 68.

[4] *Certain Broker-Dealers Deemed Not To Be Investment Advisers*, Release Nos. 34-42099; IA-1845; File No. s7-25-99 (Nov. 4, 1999).

[5] *See Letter from the Investment Counsel Association of America to Jonathan G. Katz* (Jan. 12, 2000); *Letter from Consumer Federation of America, Certified Financial Planner Board of Standards, Investment Counsel Association of America, and National Association of Personal Financial Advisors to Jonathan G.*

fundamental importance for many investment advisers and broker-dealers. Of primary concern for the Commission, however, we believe the rulemaking represents a significant opportunity to provide better notice and information to investors regarding the differences that exist between the core activities of broker-dealers and investment advisers – particularly when they are engaged in similar activities – as well as the rules, legal standards, and other regulations that govern broker-dealers and investment advisers.

In our initial comment letter to the Commission – written 5½ years ago – we noted that "[d]espite dramatic changes that are occurring in financial services, fundamental differences remain that distinguish core investment advisory functions from core brokerage activities, including the fact that investment advisers owe a strict fiduciary duty to their clients." We also agreed with the Commission's core proposition that a "functional test focusing on the nature of services provided (rather than the form of the broker-dealer's compensation) is appropriate in determining whether and under what circumstances a brokerage account may be excluded from provisions of the Advisers Act." [6] We further requested modification of three specific areas of the proposed rule:

- The rule should treat discretionary brokerage accounts that charge commissions in the same manner that it treats discretionary brokerage accounts that are fee-based.
- The rule should clarify that an account that receives discretionary advisory services is by definition not "solely incidental" to a broker-dealer's business.
- The rule should prohibit broker-dealers from advertising advisory services that are "solely incidental" to the conduct of the broker's primary business. Alternatively, the rule should require more meaningful disclosure in advertisements and any other materials that market advisory services of broker-dealers – and in contracts and agreements governing such accounts – in order to inform consumers of the significant differences between advisory and brokerage accounts, functions, and legal responsibilities.[7]

We are pleased that the final rule approved by the Commission addresses many of the concerns that we identified. We believe the changes in these areas collectively represent a major improvement to the rule as it was initially proposed. First, the final rule generally treats commission-based accounts in the same manner as fee-based accounts.[8]

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*Katz* (May 31, 2000); *Letter from Consumer Federation of America, Fund Democracy, Investment Counsel Association of America, Financial Planning Association, Certified Financial Planner Board of Standards, and National Association of Personal Financial Planners to Hon. William H. Donaldson* (May 6, 2003); *Letter from the Investment Counsel Association of America to Jonathan G. Katz* (Sept. 22, 2004); *Letter from the Investment Counsel Association of America to Jonathan G. Katz* (Feb. 7, 2005).

[6] *Letter from the Investment Counsel Association of America to Jonathan G. Katz* (Jan. 12, 2000).

[7] *Id.,* at 2.

[8] The final rule clearly states that a broker or dealer is providing advice that is *not* solely incidental if it exercises "investment discretion" (as defined in section 3(a)(35) of the Securities Exchange Act) over any customer accounts. The rule also contains an exception from the definition of investment discretion where such discretion is "granted by a customer on a temporary or limited basis." Release, at 116-117. The release cites several specific examples of situations that would constitute "temporary or limited" grants of

Second, the final rule explicitly provides that accounts over which the broker or dealer exercises investment discretion are *not* solely incidental to their primary business.[9] Finally, the final rule requires broker-dealers to include a prominent disclosure statement in advertisements, contracts, agreements, applications, and other forms related to accounts for which they receive special compensation. While we would have preferred additional disclosures,[10] the disclosure statement in the final rule reflects significant progress from the original proposal. On balance, our organization appreciates the serious consideration given to these important issues by the Commission and we certainly recognize the improvements that were adopted in the final rule in response to suggestions made by the Investment Adviser Association and other interested parties.[11]

Going forward, we respectfully suggest two additional issues for further action by the Commission and its staff. First, we urge the Commission to dedicate adequate resources to ensure that the rule is properly implemented and that broker-dealers comply fully with its requirements. Particularly given the lengthy period of time that elapsed since the original rule was proposed, we believe it is both appropriate and reasonable to give this matter serious attention during the rule's initial implementation period. Focusing resources at an early stage of the proceedings will help to promote and ensure compliance with the rule in the future, will help reduce any uncertainties associated with the rule by promoting clear recognition and adherence to the final rule, and will assist in restoring the demarcation between brokerage and advisory activities under provisions of the Investment Advisers Act.

Second, we believe the Commission can and should play a much more proactive role in educating investors and consumers about the fundamental issues involved in this rulemaking. The Commission's Office of Investor Education and Assistance, for example, could take a leading role in developing and providing educational information to the public about the confusion that may arise when broker-dealers provide investment

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discretion. We trust the Commission will closely monitor this aspect of the rule to ensure that the exception does not swallow the general rule.

[9] *Id.*

[10] Our Feb. 7, 2005 comment letter on the Commission's reproposed rule stated as follows: "Although the reproposed disclosure is significantly improved, we believe that it does not go far enough. A broker should be required to identify the duty it has undertaken with respect to these accounts, whether fiduciary or otherwise, both in its marketing and its contracts with customers. A non-discretionary account holder should not be led to believe that the broker is continuously supervising the account and proactively alerting the customer to market, economic, issuer or other changes that require action, if the broker is not subject to an investment adviser's overarching fiduciary duty. Further, the disclosures regarding duties made in marketing or advertising material should be consistent with duties undertaken in the brokerage agreement. In other words, the marketing should not tout a relationship of trust and confidence while the contract is disclaiming fiduciary duty."

[11] We are, of course, aware of the petition for review filed by the Financial Planning Association related to the rulemaking. *The Financial Planning Association v. Securities and Exchange Commission* (July 20, 2004; D.C.Cir.). It is clear to us that the final rule would not have been issued in the absence of the FPA's initiation of its lawsuit and thus we recognize and commend FPA's key role in resolving these important regulatory issues.

advice to their customers. Our review of the on-line publications currently available on the Commission's web site indicates no information published by the Commission that addresses the potential confusion created in such circumstances.[12] As the Commission's own focus groups clearly revealed,[13] investors "were generally confused about the distinctions between brokers, financial advisors/consultants, investment advisers and financial planners."[14] Accordingly, we recommend that the Commission take this opportunity to inform investors and the public about the differences between brokerage and advisory activities, the laws and regulations governing each, and specific issues raised by this rulemaking. We would be pleased to work with the Office of Investor Education and Assistance and other interested parties, including consumer groups, to develop such educational materials. As we have previously expressed to you and your colleagues, we strongly believe the Commission must play a central role in educating the investing public about these important issues and we stand ready to assist the Commission in any way that may be helpful.[15]

The release accompanying the final rule also directs the Commission staff to provide "a detailed description or outline of any rulemaking that the staff would be prepared to recommend that the Commission undertake in the near term, or to recommend that the Commission ask the NASD or other SROs to undertake in the near term," and to report on options and recommendations "for a study to compare the levels of protection afforded retail customers of financial service providers under the Securities Exchange Act and the Investment Advisers Act, and to recommend ways to address any investor protection concerns arising from material differences between the two regulatory regimes." The release also includes several examples of questions the staff should consider in determining the scope of the study.[16] The staff report is due to be completed on or about July 11, 2005.

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[12] Indeed, some current publications possibly add to the confusion by failing to acknowledge even the most basic differences between brokerage activities and investment advisory activities. For example, the pamphlet entitled "Ask Questions" purports to provide advice to investors about making investments. But a fair reading of the document indicates that it only relates to investments with brokers (there is only one oblique reference to the term "investment adviser") despite the fact that much of the information appears to relate to investment advisory services.

[13] *Results of Investor Focus Group Interviews About Proposed Brokerage Account Disclosure* (Mar. 10, 2005).

[14] *Id.*, at 8.

[15] As one element of the disclosure required of broker-dealers in connection with the final rule, the prominent statement "also must identify an appropriate person at the firm with whom the customer can discuss the differences." Release, at 115. We are skeptical that this aspect of the rule will provide investors with *objective* information about the differences between brokers and investment advisers. This aspect of the rule underscores the need for the Commission: (1) to develop public information that is readily available to investors relating to these issues; and (2) to closely monitor how firms are complying with the new rule, including this particular requirement.

[16] Release, at 68.

The issues identified by the Commission to be addressed in the staff report are of great importance to our organization. These issues involve fundamental questions about regulations and legal standards governing the conduct of broker-dealers, investment advisers, and dually registered entities and whether such regulations and standards adequately protect the interests of investors and consumers. Should the Commission decide to move forward with this initiative, the Investment Adviser Association would welcome the opportunity to participate in a meaningful manner and to assist the Commission in understanding the concerns of the investment adviser community. However, we feel the Commission should proceed carefully to ensure that the interests of all interested parties are appropriately represented and that the study is conducted in a thorough and evenhanded manner. If the Commission determines that a study of these issues is appropriate, we feel strongly that the Commission should seek to include the views and participation of interested parties, including consumer and investor groups, the investment advisory profession, the brokerage industry, financial planners, practitioners, and other interested parties.

We believe the Commissioners, based on input and recommendations from staff, should take overall responsibility for all aspects of any such study. Before making a decision to proceed with any rulemaking or major policy recommendation (including any legislative changes), we believe the Commission should seek written comment from interested parties. The Commission also should consider whether a public forum would be appropriate for the purpose of encouraging a dialogue among various interested parties and viewpoints.[17] If the Commission chooses to enlist the assistance of outside persons in conducting the actual study,[18] we feel very strongly that the Commission should seek persons who can demonstrate knowledge of applicable laws and regulations, who represent a balanced perspective, who do not have a personal interest in a particular regulatory outcome, and who can demonstrate a commitment to investor protection. Enlisting the assistance of outside persons may be helpful in considering "outside-of-the-box" perspectives and in potentially identifying institutional or jurisdictional barriers that may impede consideration of appropriate policies. An outside party, for example, may bring a fresh and objective perspective to certain issues in which various divisions of the Commission have a vested interest. However, the Commission should avoid designating any person or organization that has a perspective favoring a particular outcome or constituency. For example, NASD clearly would not constitute an impartial third party. Written comments filed by NASD in the subject rulemaking underscore how institutional and proprietary concerns can override an objective discussion of the salient issues. NASD's most recent comment letter[19] represents a vigorous statement advocating in

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[17] The Commission's *Roundtable on Investment Adviser Regulatory Issues* (May 23, 2000) is a good example of how a forum may be structured to help identify relevant issues, concerns, and potential solutions.

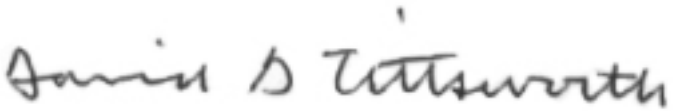
[18] Among other items, the staff is directed to report on "appropriate persons, both within and *outside* of the Commission, to be involved in the study." Release, at 69 (emphasis added).

[19] *Letter from Elisse B. Walter to Jonathan G. Katz* (Apr. 4, 2005).

favor of NASD's broker-dealer regulatory scheme. The letter echoes NASD's longstanding argument that investment adviser standards are not as protective for consumers in comparison to broker-dealer requirements.[20] The point here is not to debate the merits of NASD's position on these issues, but simply to suggest that NASD certainly is not an appropriate third party the Commission should designate for purposes of conducting such an important study.[21]

We would be pleased to provide any additional information you or the staff may require regarding these important issues.

Respectfully submitted,



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Ms. Annette L. Nazareth
Mr. Meyer Eisenberg
Ms. Susan F. Wyderko
Ms. Mary L. Schapiro
Ms. Elisse B. Walter

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[20] For example, NASD describes an investment adviser's fiduciary duty as "imprecise and indeterminate" and "more implied than expressed", concluding that such an "implied duty *simply cannot* afford retail investors with the same level of protection as the explicit regulatory standards governing the conduct of business as a broker-dealer…" (emphasis added) *Id.* at 2.

[21] In the spirit of full disclosure, our organization has for many years opposed the creation of a self-regulatory organization for the investment adviser profession, as well as NASD's potential role as such. For example, the following is an excerpt of our written testimony from the Commission's *Roundtable on Investment Adviser Regulatory Issues*: "We continue to oppose the creation of a self-regulatory organization for the advisory profession. An investment adviser SRO is unwarranted and would impose a new layer of cost and bureaucracy on the profession. And the reasons that persuaded Congress to authorize the creation of an SRO for broker-dealers – the high level of interconnectivity between broker-dealers, the number of documented cases involving investor fraud, conflicts of interest, and overly aggressive sales practices, as well as the highly technical issues related to settlement, execution, and reconciliation involving broker-dealer transactions – simply do not exist in the investment advisory profession. NASDR seems to have its hands full in dealing with problems that exist at the core of the broker-dealer industry. Instead of worrying about extending its reach to another industry, it would do well to stick to its core mission of regulating the brokerage industry and to coordinate with the SEC and other regulators in addressing novel issues that may be created by changes occurring in financial services." *Statement of David G. Tittsworth, Executive Director, Investment Counsel Association of America* (May 23, 2000). We continue to endorse these previous comments.